
MARKET BASED SOURCING DRAFT LEGISLATION

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How the Draft Legislation impacts Multistate Service Company

No state can tax all of a multistate company's income (Fed. Law). However, each state has flexibility to choose how it determines the percentage of income to tax.

Existing NC law for a service company (includes S.L. 2015-241, HB 97)

- % of income taxed = % of company's income producing activity in NC.
- "Income producing activity" equates to employment and capital investment.
- So, the larger the percentage of the company's employment and capital investment in NC, the larger the percentage of the company's income subject to NC tax.

Draft Legislation

- % of income taxed = % of revenue received from NC market
- So, an increased percentage of employment and capital investment in NC does not result in an increased percentage of the company's income being subject to NC tax.

*The percentage is called a sales factor. The draft calculates the percentage using a method called "market sourcing."

Economic Incentive Consideration

- With the draft legislation, a service company that conducts its operations primarily in NC but that receives its revenue from customers in many states will tend to have a lower percentage of its income subject to NC tax than it would under existing law.
- The percentage of a company's income taxed by NC has no effect on the percentage of a company's income another state chooses to tax. So, companies look favorably on a state that taxes a low percentage of its income along with having a low tax rate.
- 23 states have chosen to determine the percentage of income that it will tax using similar legislation, including GA and TN. VA is considering.

Other Considerations

- What specific businesses are opposed to the legislation and what alternatives do they offer that might work for them while maintaining the economic development objective of market based sourcing?
- What is the fiscal impact? (available after informational reports are filed in April) Department of Revenue guidelines for report are published.

http://www.dornc.com/headlines/2016/marketbased_sourcing.html

- If legislation enacted, do Department administrative rules need to be subject to a review/approval process?

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